DOW THEORY LETTERS INC.

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THE MARKET: According to Dow's Theory, the signal for a primary bear market was given on May 5, 1966. In a bear market, time is the enemy of every rally. The reason for this is that rallies constitute movements against the main or primary trend, and the longer a rally (within a bear market) lasts, the nearer one is to the next crash to new lows.

One should remember that it is a characteristic of bear markets to produce rallies that "look good." In their upward explosiveness and force, many bear market rallies appear more convincing than do upward movements in true bull markets. But by definition, as long as the primary bear market is in effect, then each rally must ultimately fizzle, only to be followed by a fresh collapse to new lows for the Averages.

And that is why this bear market is so dangerous. It is a young bear market, having begun only five months ago on February 9. Actually, there has not yet been any true "crashing" action on the downside, but I do not know how many more weeks or months can go by without just this type of movement occurring. The longer the primary bear forces are held "in check" by this rally, the better the chances that the whole market structure will suddenly and unexpectedly cave in, producing new lows with a rapidity which will serve to trap many of the current "get-rich-quick" speculators.

It is the nature of bear markets to produce losses. Only a few months ago during April and May all interest was centered on Airlines, Color-TV and a few other stock groups. Suddenly, many Color-TV shares have locked their new owners in with substantial losses, fewer Airlines are making the new high list, and interest has again shifted. It is entirely probable that the Color-TV shares such as Motorola, Admiral, Zerox, Magnavox have hit their highs and are now heading for substantially lower ground. Only 33% of all stock groups and only 34% of all stocks are in bullish patterns now. Yet, while all this is occurring within a confirmed bear market, many analysts are urging new buying and new investment programs. To me, this is tantamount to putting out a line of shorts in the latter stages of a bull market reaction. The scalping action may produce profits, but the odds are that before the speculator is finished he will be treated to sleepless nights and losses.

Remember, the Industrial Average struck its old bull market peak on February 9. On April 23, even while Industrials were falling, Barron's Low-Priced Stock Index and many

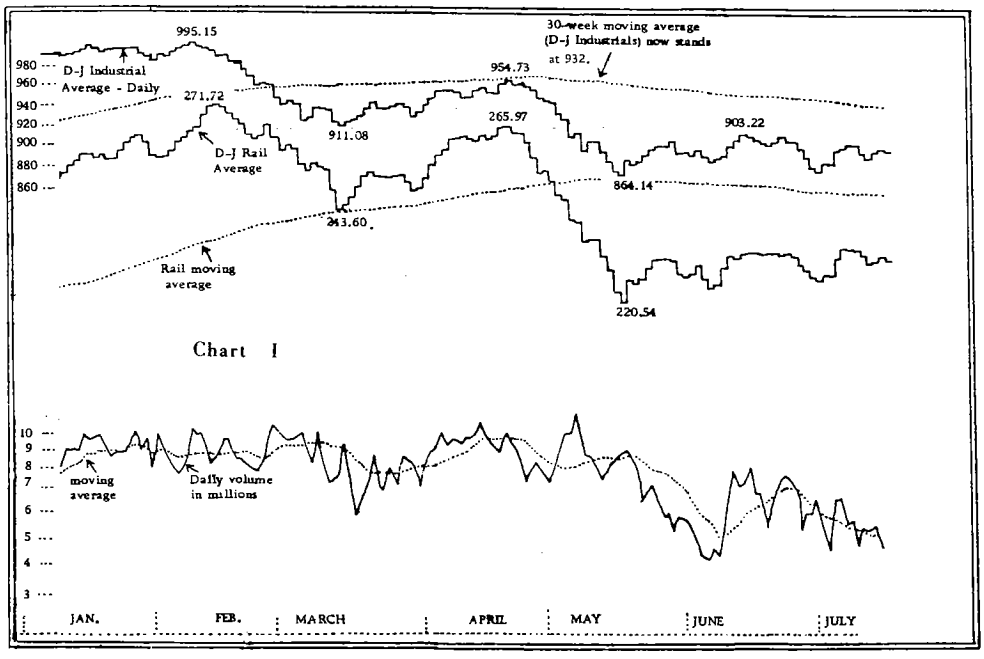
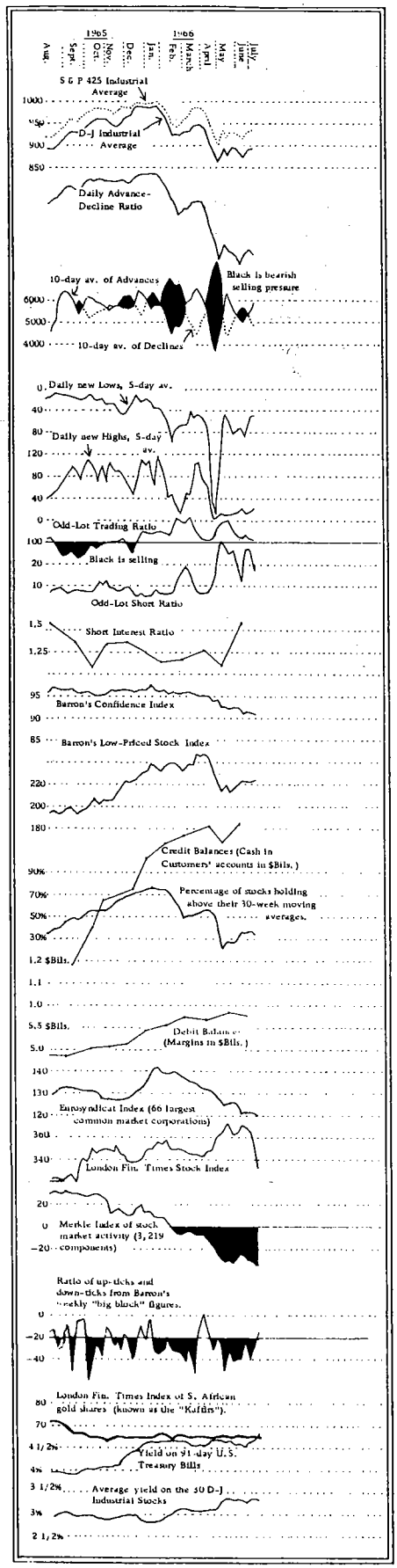


Chart I


1965
1966
S & P 425 Industrial Average
D-J Industrial Average
Daily Advance-Decline Ratio
10-day av. of Advances
Black is bearish selling pressure
10-day av. of Declines
Daily new Lows, 5-day av.
Daily new Highs, 5-day av.
Odd-Lot Trading Ratio
Black is selling
Odd-Lot Short Ratio
Short Interest Ratio
Barron's Confidence Index
Barron's Low-Priced Stock Index
Credit Balances (Cash in Customers' accounts in $Bils.)
Percentage of stocks holding above their 30-week moving averages.
Debit Balance (Margins in $Bils.)
Equity Index (60 largest common market corporations)
London Fin. Times Stock Index
Merkle Index of stock market activity (3,219 components)
Ratio of up-ticks and down-ticks from Barron's weekly "big block" figures.
London Fin. Times Index of S. African gold shares (known as the "Kaffirs").
Yield on 91-day U.S. Treasury Bills
Average yield on the 30 D-J Industrial Stocks

speculative shares rallied and established their peaks. Lately we have seen a revival in the "blue-chip" segment of the market, while interest seems to be lacking in the more speculative low-prices issues. This whole performance is not too unusual. At most major bull market tops (or at the beginning of major bear markets) it is fairly common to see one final abortive movement in the blue-chips prior to the main cave-in. I believe that this is what we are seeing now. Interest has shifted away from many of yesterday's high-flyers and glamour stocks to such "values" as American Telephone, duPont, General Foods and Proctor and Gamble. In other words, we are getting a sort of frantic rush of money first to the blue-chips, then to the speculative and low-priced shares, then back to the blue-chips. All the while the movement is seen to be narrow, confined to a small number of stocks in each group and a small number of groups. The breadth (see later section) has been poor on the rise, and volume has failed to come in as it did during the December-January rise or during the March-April rally.

The time element of the bear market may now be of interest. Going back over a few of the bear markets of the past we note that the 1929 bull market touched its high on September 3. The major bear market action began a month later on October 10. The 1937 bear market struck its peak on March 10. The beginning of the collapse started on August 13, approximately five months later. The 1946 bull market hit a high on May 29. The major bear market action began on July 2, just five months later. In the current instance the bull market established its peak on February 9. It is now more than five months since that date. Judging by bear markets of the past, the time element must now be considered both bearish and dangerous. By my reckoning and based on past history, this is not the time to engage in speculating for a bear market rally. Instead, I view it as a chance to sell any shares which you may hold in your portfolio. It is a time to be in a thoroughly defensive position, preparatory to weathering the main and most drastic part of the bear market.

NOTES & QUOTES: Under the leadership of de Gaulle, France continues to gather power (following its defeat and humiliation of the 1940's). The height of French humiliation was reached at Yalta. At that time Russia was given an empire and America was given a huge sphere of influence. France was not even consulted, a shame de Gaulle will never forget. For France, the road back to power developed along two fronts, a powerful monetary system and nuclear power. The first has already been accomplished and the second France is working on. In the early 1960's de Gaulle asked President Kennedy for permission to share in the U.S. nuclear "pile," but his request was never even answered. Kennedy, instead, developed the multi-lingual bomb carrying ship.

The NATO concept of U.S. command of nuclear power, plus the stationing of U.S. troops in France constituted anotner humiliation for France. By pulling out of NATO, de Gaulle has removed this "shame" to France, while at the same time he has shown the NATO concept to be archaic. The NATO pullout has also embarrassed the U.S. and forced a reappraisal by leading thinkers throughout the nation. But over the past year another change has occurred. People no longer ridicule de Gaulle. "Little France" is no longer sneered at. De Gaulle has moulded France into a power to be reckoned with by all nations.

The most recent move was de Gaulle's trip to Russia. While political in nature (France has a large communist party membership), it nevertheless casts him in a still larger light as the "sane" leader. In the eyes of the massive populations of India, Africa and Asia, de Gaulle is the most respected and popular leader in the West.

* * * *

Meanwhile, the U.S. has expanded the war further, bombing important N. Vietnam supply centers and sending chills of fear throughout the rest of the world. President Johnson has now taken a major step towards handing the war over to the Pentagon. In so doing, LBJ has succeeded in lowering U.S. prestige to the point where most nations of the world have serious doubts about U.S. leadership. Relations with Russia are becoming strained, and Japan is frightened almost to the point of hysteria (she is seeking to downgrade her relations with the U.S. while increasing her overtures towards Communist China). It is no secret that the U.S. is preparing to increase her manpower commitment to the 425,000 point in Vietnam, and a land war for the U.S. in Asia is becoming an increasing reality.

I think the following quote from James Reston of the New York Times (July 1) is characteristic of the thinking of intellectuals not only in the U.S. but everywhere:

WASHINGTON, June 30—The Johnson Administration may finally get over its agony in Vietnam — it may even achieve its military objective in the end — but it will probably never regain the confidence it has lost in its judgment and veracity.

With the bombing of targets on the outskirts of Hanoi and Haipong, it has now done almost everything it said or indicated it would not do except bomb China, and the end of this melancholy chapter in American history is not yet.

The Johnson Administration said it was not seeking a military solution to the war, and it is now obviously seeking precisely that. It said it was there merely to help a legitimate government defend itself, and it has ended up by replacing a military clique that is not a government not legitimate and is not really defending itself.

Johnson's Guile

Even when allowances are made for the uncertainties and moral ambiguities of warfare, the gulle of this Administration, exercised in the name of high and even noble principle, is hard to match. It was not going beyond the Seventeenth Parallel in Vietnam, but went beyond. It was merely going to respond to enemy attacks on its bases, but it went over to the offensive. It was not going to get involved in a major war on the Asian land mass, but it did.

The President was not even faithful to his bad resolves: He said he would not negotiate, but then offered to do so, and spoiled that by refusing to negotiate with the major elements of the enemy he faces. He has not merely misled his enemies but his friends. His old colleagues in the Congress have not forgiven him yet for tricking them into support of a blank check defense of all of Southeast Asia under circumstances they could not possibly oppose. And even in this last adventure in Hanoi and Haiphong, we are told officially that these bombings are not an "escalation" of the war.

* * *

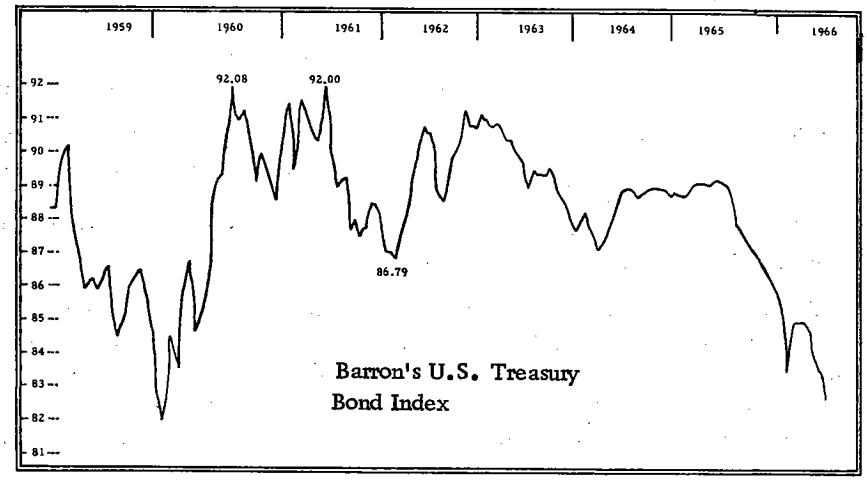
The Committee of Ten (the monetary group) has adjourned after giving up hope of creating a new ersatz gold currency or CRU. With the gold supply drying up (due to hoarding) and paper currencies increasing (due to the printing presses) the gold exchange standard faces a breakdown. Thousands of informed investors across the world are now attempting to protect themselves against the impending bankruptcy. The dollars price of gold rose last week to $35.185, highest price since last September.

Reflecting tightening money and other anti-inflation methods, the Eurosydicat index of the 66 largest Common Market corporations dropped last week to its lowest level in seven years (see composite chart on page 1).

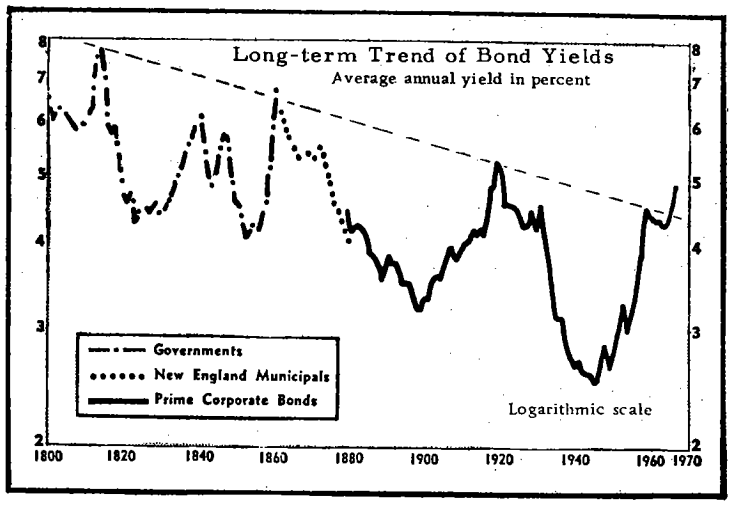
I want to stress again that the strongest force in the stock market is steady buying or selling by large investment interests. But big investment money is not interested in this market. Large investors are scared of what they see on the political front, they do not like the uncertainties of the Vietnam situation, they do not like the "tired" look of most of the leading blue-chip shares (they know that these same stocks led the bull market up ever since 1949). But perhaps most of all, big money does not like what it sees in the bond and money markets. To have any knowledge of the bond and money markets is to be frightened today.

Last week the D-J Municipal Bond Index touched a yield peak of 3.97%, the highest yield level (and the lowest price level for these bonds) since 1934. At the same time the D-J 40 Bond Index broke to a six-year low. Last week Chase Manhattan Bank moved its rate on some broker's loans backed by Government securities to as high as 6½%. U.S. Treasury bonds were hit hard again with many

issues rising to yields above 5.3% (remember the poor old "magic five" interest rate?). Pressure on international money rates continues as Britain on July 14 announced a boost in their bank rate from 6% to 7%, following a rate boost by South Africa the week before. In the last two months, no less than seven nations have raised their bank rates--Britain, S. Africa, Holland, Belgium, Sweden, West Germany and Switzerland. The U.S. is almost sure to be next.



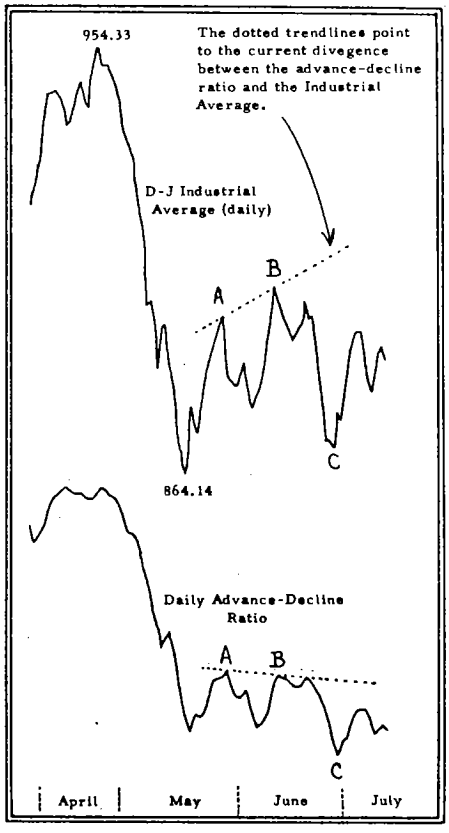
I am including two charts which illustrate rather dramatically what is occuring in the money markets today. The first chart shows 166 years of bond yields, going back to 1800. Note the previous major yield tops. Each of these corresponded with the termination of a major bear market in bonds. Note also that the 1929-32 bear market occurred within the framework of a major bull market in bonds. Thus the bond market during 1929-32 held up relatively well.



But in 1946 (due to mass deficit spending on the part of the Government) a new major bear market in bonds began. That bear market is still in progress. Recently bond yields have broken decisively above the long trendline which extends back to the early 1800's. What does this mean for the money and bond markets? We can only speculate on the final result, but I would think that within the next year the money markets could be in a state of crisis with long-term U.S. Treasure bonds in the 6% or above yield area. This is not as fantastic as it sounds, since better than 20 of the listed U.S. Treasuries now provide yields of 5% or better.

The second chart follows the path of Barron's Treasury Bond Index since its low in 1959. Here we see the massive top which has formed in this Index. The top appeared to have been completed in late-1965 when the Index broke below its 1962 low of 86.79. If or when the Index falls below its 1960 low in the 82.0 area, I would guess that demoralization would envelope the bond markets.

Conclusion: The bond yield picture is now in a dangerous state. The fat yield provided by leading bonds must (and is) putting pressure on the stock market. It would appear that the major bear market in bonds is continuing. Nothing has occurred so far to make us think otherwise.



BREADTH-PRICE RELATIONSHIP: The relationship of the daily advance-decline ratio and the Industrial Average is worth examining in detail at this time. Note on the chart that at the May high ("A") both the Dow and the A-D ratio established recovery peaks. A decline occurred, followed by a new recovery high for the Dow in June at B. A sharp slide then took place, and the A-D ratio at C broke to a new low. This was not confirmed at C by the Dow. Next the market rallied into July, and at the present time it is obvious that the A-D ratio and the Dow are "out of gear."

Many important declines have been prefaced by "triple divergence" or a series of three successive new highs on the Dow with three corresponding lower peaks on the A-D ratio. So far, points A and B comprise two-thirds of a potential triple divergence. If the Dow was to rally above 903.22 (B) while the A-D ratio remained below its last peak at B we would have the formula for a triple divergence. Completion of such a pattern would then require both the A-D ratio and the Dow to turn down and break below their recent lowest levels (the Dow would have to break below 864.14, the A-D ratio would have to break below point C or the June low).

While the pattern may or may not develop as outlined above, subscribers should bear in mind that a new high for the Dow above the June peak of 903.22 would not necessarily

 be bullish. It would have constructive implication only if confirmed by a rally in the A-D ratio above point A. Judging from the sluggishness of the A-D ratio over recent sessions, this is not about to happen.

CORRECTION: Letter 328, page 4, 3rd paragraph should read: "In the true head-and-shoulder top, volume is highest on the left shoulder, it contracts on the head, and it should contract even further on the third rally (i.e. the right shoulder).

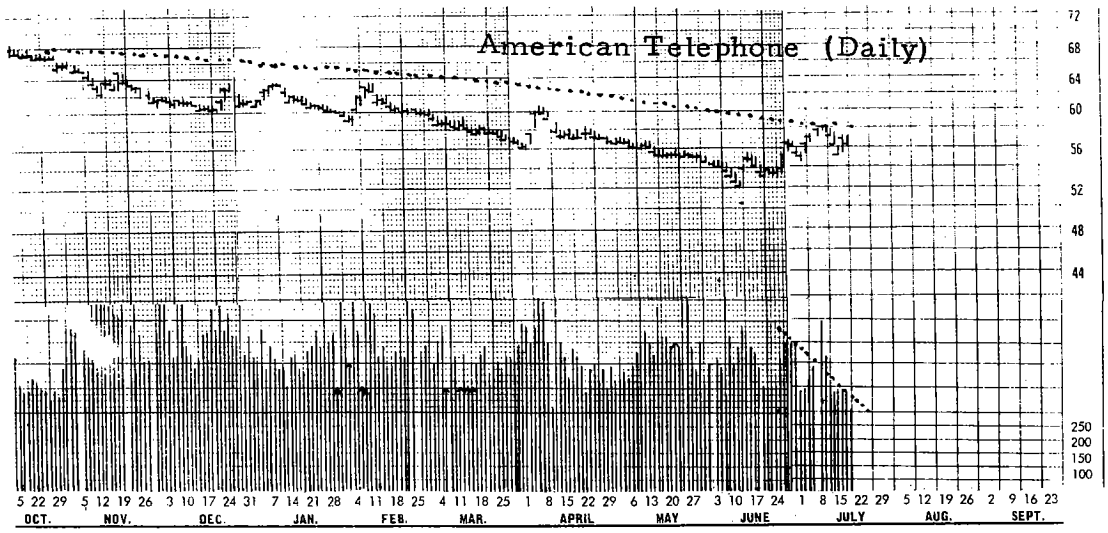
QUOTE of the week, from the July 13 Janeway Letter by economist Eliot Janeway: "We know of no one with any responsible basis for reading the situation in Vietnam who does not regard the U.S. commitment inescapably as one for a very long time indeed. Certainly, the entire point of the tremendous scale on which we are putting money and facilities into the South Eastern Asia theatre - outside South Vietnam - assumes a long drawn - out siege. Some of the installations projected in neighboring areas aren't even scheduled for completion for several years.

"Indeed, these long-range, far-flung commitments of ours for permanent facilities and installations elsewhere in the area are taken by North Vietnam and Red China as our most provocative moves and (with reason) as the basis for the enemy's most bitterly resentful and genuinely frightened counterclaims. We hasten to add that we applaud these moves of ours to dig in for the long pull as realistic assertions of the national interest. But they don't go with flash intimations that the war is going better or that the beginning of the end is in sight. It will take years to see completion of our 'dig-in' projects."

LATE NOTES: The British market, following the new bank rate and the new set of business restrictions, has collapsed, dropping from the high of 375 to today's low of 331 in a single month.....U.S. 91 day Treasury bills rose to another record high of 4.99% (yield) last week.....Three funds, American Business Shares, Pioneer Fund and Value Line Fund, now have a position in Western Deep Levels (the S. African gold mine).....Dome Mines (also recommended continually here) rose today to another all-time high of 49 1/8. Dome is up over 20% in the last month. While American South African is now resting, Dome seems to be getting the main portion of new investment buying.

STOCKS: I have stated that a characteristic of a bear market is that it produced losses. It appears to me that speculators and the public are rushing around like blind ants, picking up first one issue, then the other. As interest dies in each respective "specialty," these buyers lick their wounds and go into the next "bargain." Result: a gradual accumulation of losses all over the board. It has been easier to lose money than make money since February, and the daily new highs and lows prove it.

Along these lines, I think the daily chart of American Telephone is interesting. This stock was suddenly the subject of much interest about a month ago, as a number of leading services recommended it for purchase. One large and much-advertised fund was said to have taken a large position in Telephone. Note on the chart that T rallied (on the recommendations) to its 200-day moving average (dotted line), then turned down. Furthermore, a small head-and-shoulder pattern has now formed in T with volume decreasing as the move progresses. At 54 this tiny H & S pattern will break down, and if this occurs it will be interesting to see if T hits the new low list again. At today's price of $55\frac{1}{2}$, T is already $2\frac{1}{2}$ points off its July rally high. (Chart of T courtesy of Traders Research, 1431 Pearl St., Alton, Ill., 62003).



LATE MARKET NOTES: Written Tuesday, July 19, after the opening: The "summer rally" began unusually early this year, actually starting at the May 17 low of 864.14 for the Dow. The peak of the rally was recorded in mid-June at 903.22. So far, the June high for Industrials has not been bettered in July. Summer rallies that start early (as this one did) often end early, and for this reason I would guess that if we do not get started on the upside before July is out, then there is a good chance that we have seen the best of the upside action for this summer. This continues to be an extremely deceptive primary bear market. The longer the current trading range lasts without producing significant upside progress, the nearer I feel we are to the next major bear leg on the downside.